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1. European Payment regulation: And the beat goes on

Roadmaps, Roadmaps, Roadmaps. The EU Commission seems to be busier than ever with respect to payment regulation. There is a Green Paper Roadmap,[1] a SEPA governance Roadmap (Improving the governance of the Single Euro Payments Area (SEPA)), a PSD Review Roadmap (Review of Directive 2007/64/EC on payment services in the internal market (PSD)). In addition, the EU Commission ponders a "Single Market Act II (SMA II)"[2] – only about a year and a half after publishing the first one. Needless to say that the SMA II also addresses the topic of payments.

The main problems listed in the Green Paper Roadmap are:

- multi-lateral interchange fees
- rules that limit the capability of merchants not to accept premium cards
- refusal by banks for third party providers to access information on payment accounts
- ambiguous and to some extent outdated scope of the PSD
- inconsistent application of some of the PSD provisions and options
- diverging administrative and supervisory practices at national level
- surcharging and rebating practices leading to confusion or complaints

What are the options? The EU Commission considers the following policy options (Green Paper Road Map):

- 'Do nothing'
- 'Soft law': Commission Communication or Recommendation addressing the main hurdles for integration

[1] Follow up to Green Paper: Towards an integrated European market for card, internet and mobile payments, incl. the reviews of Directive 2007/64/EC on payment services in the internal market (PSD) and Regulation (EC) No. 924/2009 on cross-border payments in the Community.

[2] European Commission: Single Market Act II. Together for new growth, Brussels, 3.10.2012, COM(2012) 573 final.

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- Legislative proposal following the currently on-going review process for the PSD and cross-border payments Regulation
- New legislative instrument

The EU Commission seems to favour the idea to address the identified problems in a revised PSD. Thus, in the end, the Green Paper can be seen as an instrument to widen the scope of the PSD review.

With respect to SEPA governance, the EU Commissions favours a "soft law" solution in order to "*ensure more openness and improved stakeholder balance*" and "*improve the quality of advice from the SEPA Council with a view to better contribute to the definition of the retail payment strategy by the Commission*".

The topic of payments has also found its way into the proposed SMA II. The title of "Key action 8" is "Support online services by making payment services in the EU more efficient". Under this heading the EU Commission once again claims that payments are an important impediment of cross-border trade. As a consequence, a revision of the PSD is proposed and "*a legislative proposal on multi-lateral interchange fees for card payments*".

Comment

One might think that there is something awfully wrong with European retail payments. Apparently, there must be huge problems waiting to be solved. Otherwise it would be hard to explain the flurry of activities of the EU Commission. Our problem is that we do not see the problem. It is true, x-border credit transfers used to be slow, burdensome and expensive. But that has been solved a long time ago – first by reducing prices and second by introducing SEPA Credit Transfers. What other grave problems are there? Most card holders can use their cards almost anywhere in Europe to make a payment or withdraw cash from an ATM. When people shop on the internet they usually have a large choice of payments instruments – many of them with x-border capability. Moreover, these instruments can be used increasingly when people enter the net via smart phones or PDAs.

Of course, any rules and practices could be improved. But as a matter of fact, they could also be made worse. In particular, with every new initiative of the EU Commission, rules and regulations seem to become more complex. In the end, complexity means less competition, higher costs and less innovation.

Innovation is also seriously threatened by the idea that standardization should take place ex ante by agreement of all market players. And it does not seem to bother the EU Commission at all that the prime examples of successful innovators that are currently moving the market –

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PayPal, Apple and Google – have all succeeded "going it alone". Does anybody seriously believe that such a success could be replicated if any innovative European product has to be marched through the mills of SEPA governance?

The statement in the SMA II about interchange seems to suggest that the EU Commission now favours a direct regulation of interchange fees rather than an application of anti-trust law. This does not come as a surprise because a precedent exits already: the regulation of direct debit interchange fees.

2. Surcharging: News from Australia and the UK

After the "super complaint" of Which?, the UK consumer organisation, the OFT has come up with an assessment of surcharging and proposes a number of remedies. It wants merchants to offer debit card payments without surcharge and to wants merchant to make information on surcharging more accessible. Now it is time for the UK government to act. The government initiated a consultation on the topic (ending October 15) and will now consider the results.

In Australia, the Payments System Board has decided to implement a new regulation that limits the maximal surcharge to the costs paid by the merchant.

Our Comment

Surcharging has become a hot topic. This is due to regulatory changes that have banned anti-surcharging clauses of card schemes. As a consequence, surcharging has become an option for merchants in many countries. Regulators have been pro-surcharging because they have seen surcharges as a way for merchants to pass on the costs of relatively expensive means of payments to consumers. Regulators hoped that this would steer consumers towards more efficient means of payment.

However, the practise of surcharging has not been an unblemished success. There have been many complaints about excessive surcharges and the use of surcharges to implement hidden price increases. This has triggered a second wave of regulation (or regulation in the making). In the EU, surcharging is a topic in the Consumer Rights Directive and in the Green Paper on e/m-payments.

For the outside observer, this looks a bit like the typical regulatory spiral. One regulation triggers another one, and yet – as does not seem unlikely – another one. Regulators do not *seem to have the time or the confidence to let their regulation work on the market and analyse the outcomes with a cool head.*

To be frank, yes it is annoying when companies like RyanAir charge an extra fee for almost any widely used means of payment. But is the harm really that significant? Or put differently: Is there still an innocent traveller left in the EU for whom such a surcharge would come as a surprise? Are consumers rally too stupid to take such practises into account? Well, it seems that regulators think they (that's us!) are.

So what are the regulatory choices? One choice is a "cost-based" surcharge. Payment costs are difficult to define, let alone measure. Therefore, such a concept is bound to lead to trouble and yet more regulation. The other possibility, proposed by the OFT, seems more pragmatic: single out one commonly used payment instrument that has to be accepted without surcharge. That is definitely easier to implement and control. The Committee on Economic and Monetary Affairs of the European Parliament proposes to have it both ways: there should be one payment instrument free of charge and surcharges levied on other payment instruments should be cost-based.[3]

3. giropay, eps and MyBank: Towards European e-payments?

giropay and eps want to develop an interoperable e-payment system. Work on technical specifications and business rules has already begun. The aim is to allow payments across the two systems without any change in the look and feel for customers.

Our Comment

After the suspension of three-way talks[4] *between iDeal (NL), giropay (DE) and eps (AT), giropay and eps have decided to move ahead on a bi-lateral basis. They are leaving the door open for iDeal to join at a later stage. The outlook remains clouded, however. Talk of interoperability has been going on for years and valuable time has been lost. Meanwhile, competition has been rising. Sofortüberweisung.de, a "so-called overlay system" has been growing vigorously and has expanded from its German base to other markets. In the interbank sphere, EBA Clearing has come up with MyBank. MyBank is the last to reach the*

[3] REPORT on 'Towards an integrated European market for card, internet and mobile payments' (2012/2040(INI)) Committee on Economic and Monetary Affairs, Rapporteur: Sampo Terho, 4 October 2012.

[4] See our June 2012 newsletter.

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market. But it is well connected with the banking world and plans to start implementation in Italy.[5] Incidentally, one of the participants in the MyBank pilot terminated this month was STUZZA, the Austrian company in charge of eps This may point towards another potentially fruitful co-operation..

4. Cost of payment studies: A sound basis for regulation?

The ECB has published a study on "The social and private costs of retail payment instruments"[6]. It covers social and private costs of cash, cheque, debit and credit card, direct debit and credit transfers.[7] The study covers central banks, banks and infrastructures, cash-in-transit companies and retailers but not households and consumers. Central banks of thirteen countries have been participating in this study.[8] In these countries, estimated total costs amount to 45 billion EUR (0.96% of GDP). For the EU as a whole (27 members), this result would imply total costs of about 1% of GDP or 130 billion EUR (p. 6).

Looking at the sectors, about 50% of the social costs are incurred by banks and infrastructures, 46% by retailers, 3% by central banks and 1% by cash-in-transit companies (CITs) (p. 6). The private costs of retailers are higher though, because they are paying fees to banks and CITs.

Table 1 Unit costs of various payment instruments

	Cash	Cheques	Cards	of which			
				Debit Cards	Credit Cards	Direct Debits	Credit Transfers
EUR/Trx.	0,42	3,55	0,99	0,70	2,39	1,27	1,92
% of Value	2,3	0,2	1,7	1,4	3,4	0,4	0,2

Source: ECB, Costs of Payments, p.28.

The most important results are the estimated unit costs of the different payment instruments. For the card industry, it is particular interesting to see the relative results of cash, debit cards

[5] See: European e-merchants call for MyBank implementation, EBA Insight October 2012, p.6/7.

[6] See „The social and private costs of retail payment instruments: a European perspective", by Heiko Schmiedel, Gergana Kostova and Wiebe Ruttenberg, ECB Occasional Paper 137, October 2012. http://www.ecb.int/pub/pdf/scpops/ecbocp137.pdf http://www.ecb.int/pub/pdf/scpops/ecbocp137.pdf

[7] "Social costs" are defined as "use of resources in the production of payment services". If, for instance, a merchant deposits cash, the time of the merchant and the time of the bank employee at the teller are counted as social costs but not the fee paid by the merchant to the bank. (Sometimes the term "resource costs" is used instead of "social costs".)

[8] Danmarks Nationalbank, Eesti Pank, Central Bank of Ireland, Bank of Greece, Banco de España, Banca d´Italia, Latvijas Banka, Magyar Nemzeti Bank, De Nederlandsche Bank, Banco de Portugal, Banca Naţională a României, Suomen Pankki, and Sveriges Riksbank.

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and credit cards. On a per transaction basis, cash is cheapest (42 cents), followed by debit cards (70 cents). Estimated costs of a credit card transaction are much higher (2.39 EUR). Looking at costs in per cent of the transaction value, debit cards are cheapest (1.4%) followed by cash (2.3%). Again, credit cards are the most costly (3.4%).

Table 2 Share of retail payment instruments in terms of volume of transactions

	Cash	Cheques	Cards	of which		Direct Debits	Credit Transfers	Other
				Debit Cards	Credit Cards			
Partici-pants*	69,12	0,95	14,34	11,34	3,00	5,99	8,49	1,11
EU27	64,57	2,50	13,51	11,61	1,90	8,74	9,63	1,06

*: 13 participating countries; Source: ECB report, p. 23.

Apart from costs, the report also provides some interesting data on the retail payments market. Thus, there is a table with the estimated market share of cash and other payment instruments. In terms of the volume of transactions cash still has roughly 2/3s of the European retail payment market. The average figure masks large differences between countries (ranging from 27% to 95%).

Our Comment

Fifteen years ago, only very few studies on the costs of payments existed. Meanwhile, studies have been mushrooming. Many of these cost studies have been carried out by central banks. The most recent one is a study of the European Central Bank (ECB).

Estimating costs of payments for a group of countries is a complex task. Thus, the ECB has been facing quite a challenge. Therefore, it does not come as a surprise that the publication of results took longer than planned. No doubt, the ECB has done an excellent job and the figures presented are highly interesting. They can serve as a kind of benchmark for other estimates. In addition to cost-estimates, the study also provides some volumetric data - such as the volume and value of cash payments in the EU - that has been missing, so far. So, on the whole, the ECB is providing interesting and relevant information on the payment market.

However, the cost study is meant to be more. In the words of the ECB: "… the study intends to provide a sound basis and a comprehensive framework for further policy making and conclusions in relation to the execution and promotion of cost-efficient retail payments for society. Therefore, the results may trigger a fruitful and constructive debate about suitable policy measures and payment instruments for improving social welfare and realising potential cost savings along the transaction value chain.*" (p. 43)*

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However, it is difficult to draw firm conclusions from the results presented by the ECB. In the report, the ECB highlights that it is no easy to interpret the figures. Thus, low unit costs may imply that a certain instrument is per se relatively cheap. But if economies of scale are important, it may also be the result of large volumes (p.27-8).

It is also difficult to generalise the results. For instance, one important finding is that the costs of "debit cards" are much lower than the costs of "credit cards". But what should we infer from this finding? Is it generally more expensive to process credit cards than debit cards? For instance, should we expect a Cartes Bancaire (CB) card in credit modus to be more than twice as expensive as a CB card in debit modus? That seems unlikely. Rather, what the study's cost estimates seem to reflect is the difference between the costs of processing a card from an international scheme ("credit card") and the costs of processing a card from one of the domestic debit card schemes ("debit card"). However, such a finding in itself does not provide a firm basis for regulatory action. As the ECB points out, volume may be an important driver of unit costs (p. 27-8). So, higher costs of international cards ("credit cards") may simply reflect relatively low usage figures. Equally important are the benefits of certain types of payment instruments.[9] An international card can be used in a large number of countries and it can usually be used for remote purchases (moto, ecommerce). Moreover, international schemes have been much quicker to innovate. Thus, regulating the market based on cost-estimates may have unintended side effects.

[9] Benefits are mentioned in the ECB report (p.15-6). But since they are hard to quantify the ECB does not undertake any attempt to estimate the value of benefits.

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