Topics of this issue:

1. **Canadian regulation of payment card networks**
2. **German savings banks want to go ahead with ec cash 2.0**
3. **Surcharging criticized by UK consumer body**
4. **A conflict in Brussels that may delay end-date regulation?**

1. Canadian regulation of payment card networks

In the year 2010, the Canadian government has introduced a number of important measures to regulate the payment card market. A "voluntary" Code of Conduct[1] has been announced in April, the Payment Card Networks Act[2] has been proposed and approved by parliament and a Task Force for the Payment Systems Review[3] has been created. The aim of all these measures is to insure innovation ion the payment system while maintaining high levels of protection for consumers and merchants.

Payment card networks, issuers and processors are not obliged to adopt the Code of Conduct (CoC). However, by mid-may all important players announced that they adopted it. Thus "moral suasion" seems to have worked. The main elements of the CoC of conduct are:

- The Financial Consumer Agency of Canada is in charge of monitoring compliance
- Information and notification requirements
- Restrictions of the "Honour all cards" rule
- Merchants are allowed to provide discounts for certain payment instruments
- Restrictions regarding competing domestic applications on one card
- Co-badged debit cards must be equally branded (same size brand marks, etc.)
- Debit and credit card functions shall not co-reside on the same payment card
- Restrictions on offering premium credit and debit cards

The Payment Card Networks Act includes the following elements

- The Financial Consumer Agency (FCA) receives regulatory power over the payment system
- Disclosure rules regarding rates charged

[1] See Code of Conduct for the Credit and Debit Card Industry in Canada, http://www.fin.gc.ca/n10/data/10-049_1-eng.asp (Version including updates as of May 18th, 2010).
[2] See Payment Card Networks Act, 12th July, 2010 (included in Bill C-9). http://www2.parl.gc.ca/HousePublications/Publication.aspx?DocId=4649148&Language=e&Mode=1&File=560#177
[3] See http://paymentsystemreview.ca.

- Advance notification rules if rates change
- Power to regulate network rules for issuers and acquirers and other issues (FCA on the recommendation of the minister of Finance)

The mandate of the Task Force is

- Assess regulatory and institutional structures for the Canadian payments system
- assess and report on the safety and soundness of the Canadian payments system
- Assess the competitive landscape by identifying any potential barriers to entry
- Assess the degree of innovation in the domestic payments system
- Assess whether consumers and merchants are well served

Based on these assessments it will make regulatory proposals the Minister of Finance.

Our Comment

From a European (SEPA) point of view, Canada is interesting to watch because the debit card market has been dominated for a long time by the domestic scheme Interac. But now Visa and MasterCard are trying to gain a share of the market. Thus, we have precisely the situation that European regulators have in mind for Europe: competition between Visa MasterCard and a third scheme.

Following a report of the Senate Banking Committee in 2009[4]*, the Canadian government has introduced a whole basket full of regulatory measures – and more may come in the future. This regulatory activity has to be seen against the background of growing importance of payment cards and the increasing competition between the national scheme Interac and the international schemes Visa and MasterCard.*

There are several noteworthy elements of the regulatory approach:

- *The Canadian government develops a specific regulation for payment card networks and endows an agency with regulatory power*
- *So far, interchange fees remain unregulated.*
- *Some measures well known from other jurisdictions are incorporated: limitations of no discount rules and honour all cards rules, transparency rules*
- *There are specific rules for co-branding / co-badging.*

The most interesting element of this list is the approach of the CoC regarding co-branding. There are three articles relating to co-branding (co-badging). Article 7, is fairly straight-forward. It states that in the case of co-branding, issuers should not discriminate between the

[4] See our from February 2010 newsletter.

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two brands (both brand marks should have the same size, etc.). Article 8 states that debit and credit card functions shall not co-reside on the same payment card. This is also easy to interpret, unless a prepaid function is included – would that be treated a credit function? Article 6, however, is not clear at all:

"6. Competing domestic applications from different networks shall not be offered on the same debit card. However, non-competing complementary domestic applications from different networks may exist on the same debit card.

A debit card may contain multiple applications, such as PIN-based and contactless. A card may not have applications from more than one network to process each type of domestic transaction, such as point-of-sale, Internet, telephone, etc. This limitation does not apply to ABM or international transactions." (Code of Conduct for the Credit and Debit Card Industry in Canada - Version including updates as of May 18th, 2010.)

When trying to interpret Article 6, the question that comes immediately into mind is, whether MasterCard and Visa are treated as domestic schemes (after all they can be used in Canada) or whether they are treated as international schemes. If they are treated as international schemes, the whole point of Article 6 remains somewhat obscure because then the only domestic scheme would be Interac. If they are treated as domestic schemes, Article 6 would basically rule out to co-brand Interac with either MasterCard or Visa debit card products. Since Article 8 rules out the co-branding of a debit with a credit brands, both Articles together would rule out the co-branding of Interac cards with any MasterCard or Visa product (with only prepaid remaining somewhat uncertain). We are not aware of any other country that has regulated co-branding in such a way. Therefore, it is interesting to ponder the question why Canadian regulators chose to include these rules in the CoC. The main motive may well have been to protect Interac. However, the question is whether these measures will achieve this goal. If our interpretation of Articles 6 and 8 is correct, it will not be possible to co-brand Interac cards with Visa and MasterCard brands other than Plus and Cirrus. Thus, an Interac card is bound to remain a national payment card (internationally usable only for cash acquisition – if co-branded with Cirrus or Plus). Visa and MasterCard, however, can offer debit cards that are usable in Canada and abroad. Therefore, it can be doubted that the CoC really improves Interac's position vis-à-vis MasterCard and Visa.

Otherwise, it remains to be seen how the regulation of payment cards will evolve. The FCS, under the guidance of the Minister of Finance, has large regulatory powers. If the Task Force were to recommend further regulatory measures, these could be quickly enacted under the Payment Card Networks Act.

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2. German savings banks want to go ahead with ec cash 2.0

At the beginning of 2010, the German savings banks presented their card strategy.[5] The main element of the new card strategy is an unbundling of payment transaction and payment guarantee. At the Bankkartenforum, Bernd M. Fieseler, Member of the Board of the German Savings Bank Association (DSGV) told the audience that the savings banks were committed to the new strategy. The other banking groups (co-operative banks and private banks) were, so far, not supporting the new approach. But the savings banks would move forward anyway.

Our Comment

The German Savings banks seem to be ready to proceed with the new debit card strategy on their own. That would imply that there will be two German debit card systems in the future "ec cash 1.0" and "ec cash 2.0" and both will be mutually incompatible. Such a move will imply a major change for the German market. Retailers and PSPs will have to adopt their systems. Banks of the other banking groups will have to rethink their strategies. In all likelihood, MasterCard will intensify its siren's songs to lure away banks from ec cash.

If the savings banks go ahead, two versions of ec cash will exist side by side. That raises some questions as to how this co-existence will be managed. Will ec cash 2.0 cards be downward compatible? Will merchants accepting ec cash 2.0 also have to accept ec cash 1.0? Will card holders be aware of the two versions?

What seems clear is that SEPA is more of a side aspect in this move. The main focus is on the German market by bringing back the ELV-transactions into the bank-owned system and on anti-trust policy. The main reason for unbundling is the hope to get the anti-trust authorities blessing for the new structure.

3. Surcharging criticized by UK consumer body

"Which?", the UK consumer body has come out with a report criticizing high merchant surcharges when paying by card.[6] Which? cites examples of a £19,000 cruise paid with a card, that costs £470 in charges and a £1.70 ticket that costs an extra £3.50 when paid by card. Such figures are compared to the standard interchange rates of £0.10 for debit cards

[5] See the April/May edition of our newsletter.

[6] Which?: Card charges rack up extra costs for consumers. Credit and debit card fees may hike prices by 200%, 28 September 2010, http://www.which.co.uk/news/2010/09/card-charges-rack-up-extra-costs-for-consumers-231564/

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and 0.8% for credit cards. Thus, the consumer body concludes that surcharges are often much higher than the actual costs of card acceptance. Which? chief executive Peter Vicary-Smith comments "*There can be no justification for high card surcharges as all too often they just seem to be an excuse for ramping up costs. While companies may want to recoup merchant fees, these charges need to be fair and transparent, so consumers know the real price before they begin a transaction.*"
The findings of Which? are broadly in line with the results of an empirical study of economists from the Dutch Central Bank who show that surcharges on PIN (debit card) transactions are often much higher than the 4-5 cents per transaction charged by acquiring banks.[7]

Our Comment

In the past years, so called "no-surcharge" or "non-discrimination" rules have received increased attention of anti-trust authorities. In many cases, anti-trust authorities have treated such rules as a violation of anti-trust law. In addition, government regulations of the payments sector have frequently addressed the issue as, for instance, in the Payment Services Directive (PSD) or the Canadian Code of Conduct (see Article 1 in this newsletter). The reasoning behind these rules is fairly straight-forward. If the authorities suspect issuers to set interchange fees too high, one solution is to allow merchants to surcharge and/or offer discounts. Thus, surcharging/discounting can be seen as a kind of "safety valve" when the pressure on merchants becomes too big. Such a "safety valve" seems preferable to dispute resolution via the courts or heavy-handed regulation by government.
However, surcharging may also have its drawbacks. It can be misused by merchants to impose hidden price increases.[8] Therefore, regulators may contemplate the idea to leave some regulatory power regarding surcharges with the payments schemes. The schemes should be allowed to set rules regarding transparency and maximum amounts (for instance limit the surcharge to the size of the merchant discount).

[7] Wilko Bolt, Nicole Jonker and Corry van Renselaar: Incentives at the counter: An empirical analysis of surcharging card payments and payment behaviour in the Netherlands, De Nederlandsche Bank, Working Paper No. 196/2008. http://www.dnb.nl/binaries/Working%20paper%20196_tcm46-210266.pdf
[8] Ryanair has been suspected of doing just that. See our December 2009 newsletter.

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4. A conflict in Brussels that may delay end-date regulation?

According to a report published by the German business newspaper Handelsblatt, conflicts between DG Internal Market and DG Competition may delay the publication of the first proposal for a regulation on SEPA end-dates that was scheduled for October 2010. The Handelsblatt reports that DG Competition is not opposed to setting end-dates but that its main concern is the continuing existence of interchange fees. Still, the conflict is likely to delay any end-date regulation.

Our Comment

We have commented extensively on the end-date debate in our last newsletter. The surprising element of the current debate is the fact that, according to the Handelsblatt, DG Competition does not have any problems with setting a mandatory end-date. If this is true, the Handelsblatt report may actually be good news for the pro end-date camp.

Should you have any questions or comments please contact

Dr. Hugo Godschalk (hgodschalk@paysys.de)
Dr. Malte Krueger (mkrueger@paysys.de)
Christoph Strauch (cstrauch@paysys.de)

PaySys Consultancy GmbH

Im Uhrig 7
60433 Frankfurt / Germany
Tel.: +49 (0) 69 / 95 11 77 0
Fax.: +49 (0) 69 / 52 10 90
e mail: info@paysys.de
www.paysys.de

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