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1. The wonderful world of anti-money-laundering regulation

In its September 22 edition, The Economist reports the results of a remarkable study on untraceable shell companies.[1] The study has been carried out by three academics from the US and Australia and is available on the internet.[2]

The results are striking: In spite of the rules of the Financial Action Task Force (FATF), that form the basis of the international fight against money-laundering, it has proven fairly easy to incorporate a shell company without proper identification.

The researchers present evidence from 7,400 email solicitations to more than 3,700 corporate service providers that make and sell shell companies in 182 countries. The three researchers summarize their key findings as follows (p.2-3):

1. *"Overall, international rules that those forming shell companies must collect proof of customers' identity are ineffective. Nearly half (48 percent) of all replies received did not ask for proper identification, and 22 percent did not ask for any identity documents at all to form a shell company.*
2. *Against the conventional policy wisdom, those selling shell companies from tax havens were significantly more likely to comply with the rules than providers in OECD countries like the United States and Britain. Another surprise was that providers in poorer, developing countries were also more compliant with global standards than those in rich, developed nations.*
3. *Defying the international guidelines of a "risk-based approach," shell company providers were often remarkably insensitive to even obvious criminal risks. (…)*

[1] See: Shell companies. Launderers Anonymous. A study highlights how easy it is to set up untraceable companies, The Economist, Sep 22nd, 2012 (http://www.economist.com/node/21563286).
[2] Michael Findley, Daniel Nielson and Jason Sharman: Global Shell Games: Testing Money Launderers' and Terrorist Financiers' Access to Shell Companies, Griffith University, Centre for Governance and Public Policy, 2012. (http://www.griffith.edu.au/__data/assets/pdf_file/0008/454625/Global-Shell-Games_CGPPcover_Jersey.pdf)

4. *Corporate service providers were significantly less likely to reply to potential terrorists and were also significantly less likely to offer anonymous shell companies to customers who are possibly linked to terror. (…)*
5. *Informing providers of the rules they should be following made them no more likely to do so, even when penalties for non-compliance were mentioned. (…).”*

Comment

Both topics, “anti-money laundering” (AML) and “anti-terrorist-financing” (ATF) are not new for those who are active in the field of payment. Indeed, complying with an ever-increasing number of regulations and ever-stricter rules has absorbed large resources of this sector. Moreover, regulations have increasingly threatened the business models of some payments service providers (PSPs), especially those of the e-money-issuers in the low-value-payments market.

Payment experts have not always been convinced of the wisdom of these regulations. But this did not make a difference since PSPs had to comply with the rules. Obviously, this is still true. But when reading that the fighters against money laundering and terrorist financing are leaving some gaping holes in the system it becomes ever more difficult to understand why they make such a fuss about payments. This is particularly so when reading that the worst shortcomings can be found in the developed countries, in particular the US. So far, we always thought that these problems were confined to some small islands in the Caribbean.

2. Green Paper: EU Parliament preparing an opinion

The consultation process with respect to the EU Commissions Green Paper has been terminated. Meanwhile, the EU Parliament is working out its opinion on the topic. The Committee on Economic and Monetary Affairs (ECON) has drafted a first report in June[3] which has been amended[4] and is awaiting a reading in the EU Parliament.

The first draft, written by rapporteur Sampo Terho has been relatively brief. Still, it contains a lot of stuff. Basically, it says that there is need for more regulation on card payments but cautions that mobile and internet payments are still at an early stage an may be severely

[3] European Parliament, Committee on Economic and Monetary Affairs, DRAFT REPORT on ‘Towards an integrated European market for card, internet and mobile payments’ (2012/2040(INI)), June 4, 2012.

[4] European Parliament, Committee on Economic and Monetary Affairs, AMENDMENTS 1 – 155, Draft report Sampo Terho (PE491.085v01-00), July 12. 2012.

harmed by too much regulation. Indeed, it calls for a "*radically different and appropriate approach to these new payment methods*" (p. 4).

Not surprisingly, the Committee is in favour of standards and interoperability and wants to promote x-border acquiring. The initial report is critical of MIF but still sees some justification for MIF and does not want to impose a maximum. (By the way: its understanding that MIF is not a balancing payment between two market sides, but as *"means to finance the four-party card payment systems"* and its statement *"that the level of MIFs is sometimes higher than what the financing requires"* is peculiar and disconcerting). Co-badging is seen as beneficial but should not be made mandatory. It welcomes the ban on surcharges in some countries but wants to leave the issue with member states. As can be expected, the Committee is advocating high levels of security. In this respect, it is concerned about third-party access to customer's bank account information.

The Committee has received no less than 155 amendments to the initial proposal. Most of these amendments indicate to more regulation. Multi-lateral interchange fees are a recurring topic, one popular idea being a zero MIF. There is a lot of criticism of surcharging and some commentators want it banned (they do not want to leave this question in the hands of the member states). Many amendments are also dealing with self-regulation. More stakeholder involvement is demanded and the EU Commission is asked to get involved more actively. With respect to internet and mobile payments, there is an amendment advocating more regulatory restraint while another proposed amendment wants more ex ante regulation. There are many amendments calling for common standards, coordinated implementation, interoperability, open standards, level playing fields etc. Co-badging is seen as beneficial but should not be mandated. With respect to application selection, there are various amendments with differing ideas: consumers should decide, merchants should decide, cardholders and issuers should decide. With respect to third-party access to account information, there are amendments proposing to make a distinction between genuine account access and access to the general information whether funds are available or not. Finally, there is the idea of having a real-time system with a common standard that links all accounts in the EU.

Our Comment

It is still too early to say what the Green Paper will imply in terms of concrete regulatory measures. However, there does not seem to be any doubt there will be more regulation. The Committee on Economic and Monetary Affairs and individual members of the European

Parliament have enthusiastically approached the topic and have come up with a wave of proposals with respect to the regulation of the payment system. The Committee has been relatively restrained, occasionally applying common sense, for instance when arguing that regulation of relatively young industries might hamper innovation or when pointing out that additional information for consumers might simply lead to "information overflow". Despite these fears of information overflow, the Committee wanted to ensure – in case of surcharging – that the customer should know how much of the surcharge comes from the MIF and how much is further imposed by the merchant.

The Committee takes over the Green Paper´s mantra of "cost-effectiveness" or "cost-efficiency" regarding different payment methods. As reader you should be aware, that this term in this regulatory context simply means plain costs, without considering any benefits of the different means of payment, which should be included in a serious cost-effectiveness approach.

The amendments to the initial document, however, portray an almost unrestricted belief in the virtues of maximum regulation of the payment sector. To be sure, not all amendments (some of them contradictory) will be passed by the European Parliament. But it seems likely that the overall thrust of the European Parliament's intervention will be to push the EU Commission towards an even more interventionist role in the payment system. Most striking is the belief that innovation requires standardisation and co-ordination. The fact that the most successful ventures in the world of e/m-payments or e/m-commerce are proprietary standards such as PayPal or Apple/iTunes seems to have been lost on European politicians. They also seem to be unaware of 12 years of failure to come up with a co-operative solution in the field of m-payments.

Otherwise the proposed amendments seem to portray a strong belief that more regulation is better than less. Thus, the EU Parliament seems unlikely to slow down the European Commission's regulatory zeal. If you are worried, call your local member of parliament.

3. Is the ECB the originator of the idea of a Basic Payment Application (BPA)?

Is a card payment a "basic product" and should it be offered as a public good with low or no costs for its users? We discussed the striking idea of a Basic Payment Application (BPA[5]) for

[5] Other terms: Basic Payment Service, Basic Card Service, Basic Card Application

cards in our last newsletter. The European Commission stressed this option as one of the results of the more than 300 feedback statements on the Green Paper "Towards an integrated European market for card, internet and mobile payments".

It seems to be that it is not a crackpot idea of some retailer organisation to get rid of the multilateral interchange fee (MIF). The European Consumer organisation BEUC mentions in its statement, that this new optional business model was discussed at the SEPA Council meeting on February 6’ 2012: "*a differentiation between `core and basic´ card payment services and `additional´ services, where consumers and merchants would be free to choose additional services and pay in a transparent way for each service chosen.*"[6] One of the topics (No. 4) of this meeting was "SEPA for Cards Business practices for increased efficiency in card payments". This item was introduced by Mr. Benoît Coeuré, member of the executive board of the European Central Bank (ECB). According to the published minutes[7] of this Council meeting he suggested some basic principles to support the establishment of SEPA for Cards, inter alia "basic card services". During the meeting this idea has not been explained any further. It is probably part of a discussion paper introduced by the ECB called "Business practices for cards", presented at the 25th meeting of the Contact Group on Euro Payments Strategy (COGEPS) in October 11th 2011[8]. A not public consultation process followed this meeting and there is a feedback of the EPC Cards Working Group, represented by Ugo Bechis in the next meeting of COGEPS on April 2,

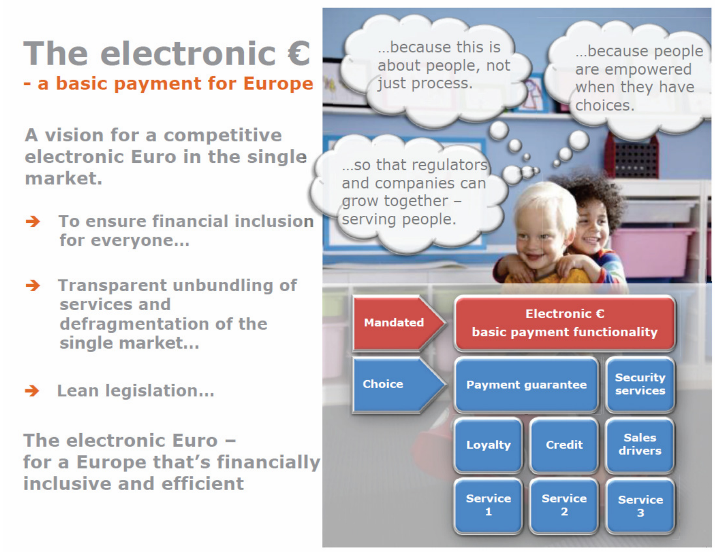

Chart presented at the Green Paper Conference of the European Commission on 4th May 2012 by Erik Øster Pedersen (CFO IKEA Group)

6 http://ec.europa.eu/internal_market/payments/cim/index_en.htm
7 http://www.ecb.int/paym/sepa/pdf/4th_sepa_council_meeting_summary.pdf?7aa0d301cce6690c49c67a1508330994
8 http://www.ecb.int/paym/groups/pdf/cogeps/cogeps_agenda_111011.pdf?729c901785fd7bb29791c3af41ff116e

2012. He stated "*the EPC supports the ECB definition of 'basic card services' and the free choice by each issuer and acquirer of the level of service he would like to offer*"[9].

Meanwhile, in the European Parliament the idea is extended to include also e- and m-payments. Thus, one of the proposed comments to the Commission's Green Paper reads as follows: "*Is therefore of the opinion that all national card, mobile and internet payment schemes should join or turn themselves into a Pan-European SEPA compliant scheme so that all card and mobile and internet payments would be accepted everywhere in the SEPA and that a necessary period should be suggested by the Commission for this transition*".

Our Comment

We still do not know exactly, what the ECB definition and suggestions are, but one thing seems to be clear: the "basic card services"-discussion was initiated by the ECB and picked up by IKEA and BEUC, who attended the SEPA Council meeting of February 2012 as members. So let us have a closer look at the ideas of the different stakeholders who have embraced the BPA (which are not necessarily representing the ECB´s position):[10]

Stakeholder	Position to BPA[11]	Our comments and & open questions
BEUC	Basic services (card present and card-not-present) should be provided free of charge by the card issuing bank.	So no fees for cardholders, but who has to pay for it?
IKEA	Basic payment ("Electronic Euro"): • Should be mandatory on all cards or devices as well as European ID cards to give access to accounts or stored value for all Europeans. • It is mandatory for all who accept cash to also accept the electronic euro. • The state (ECB) needs to control the basic payment functionality to ensure access of all citizens.	Unclear who has to pay for the basic payment functionality. IKEA says: "a reasonable fee is paid for this service." Paid by the cardholder?

9 http://www.ecb.europa.eu/paym/groups/pdf/cogeps/cogeps_summary_120402.pdf?6f573a03ecd283861ed3831da6498da8

10 Amendment -1e, in: European Parliament, Committee on Economic and Monetary Affairs, AMENDMENTS 1 – 155, Draft report Sampo Terho (PE491.085v01-00), July 12. 2012.

11 See statements of the stakeholders to the Green Paper (http://ec.europa.eu/internal_market/payments/cim/index_en.htm)

Stakeholder	Position to BPA[11]	Our comments and & open questions
EuroCommerce	Basic Payment Service: • Legislative proposal; should be mandatory for issuers and acquirers. • A facility for customers and merchants to make non-MIF payments. • Unbundling of the basic payment operation from all other additional services. • Any additional services (e.g. gifts, additional insurance, free credit, deferred debit) would be optional, negotiated between the cardholder and his bank (competitive pricing). • Would have a cost to the customer, which should not be subsidized by the merchant • Should include a payment guarantee. • Should be priced to both consumers and merchants at a fair price (cost-based). • Cardholders could decide to only have the Basic Payment, rendering co-badging an ineffective solution.	EuroCommerce is suggesting that the allocation of the costs should be cost-based on both sides of the card market (cardholders & merchants). If the issuer is delivering services to the acquirer (e.g. payment guarantee) these cost should be paid (partly?) by the merchants. Therefore the BPA-proposal is still based on a kind of MIF-structure.
ERRT (European Retail Round Table) & Carrefour Group	Basic Card Application to all bank accounts should be mandatory; “Fees for each service should be unbundled, calculated on cost and allocated directly to the party who benefits from the service.”	Also a fee for the BPA (BCA) or only fees for additional services? No free pricing, but regulation of fees for added value services (“should be calculated on cost”)?
European Travel Retail Council	Unbundling of Merchant Service Charges (MSC) for cards, m- and e-payments with a “basic possibility” at a minimum fee. This BPA-fee should be based objectively on transaction costs for transmitting funds from one account to another.	Cost-based pricing on merchant side without consideration of card specific costs.
Card Stakeholder Group Retail Sector (CSG Retail)[12]	Basic card payment service is the only solution to the price rises as result of the Visa/MasterCard duopoly. Should be a mandatory requirement of the SCF.[13] Reference is made to the German ELV-system	BPA as a kind of ELV-transaction? No statements with respect to fees.

[12] Stakeholder group set up by EPC.
[13] SEPA Cards Framework.

Stakeholder	Position to BPA[11]	Our comments and & open questions
Dixons Retail	Basic "no frills" card payment service offered to merchants, supported by a payment guarantee, with a zero or close to zero MIF. Any other benefits with that card (such as rewards, interest free credit etc.) are a matter for negotiation directly between the cardholder and the issuer. Payment guarantee has to be included within any basic package.	MSC or MIF zero or close to zero? BPA is including payment guarantee.

It is not surprising and requires no further discussion that the consumer organisation BEUC is proposing a zero fee for cardholders and that the retailers also do not like to pay for the BPA. The suggestions for a realistic cost allocation seem to be in a very rudimentary stage.

The idea of unbundling services is not new in the card market. On the card issuing side the unbundling of services is already state-of-the-art. Most banks are offering different card types to their clients: ATM-only card, debit card with local brand, debit card with international brand, delayed debit cards, real credit cards with revolving credit facility, prepaid cards without link to a current account, gold and platinum cards with a bunch of added values, etc.

The idea of unbundling the MSC for debit card transactions at the acquiring side was discussed in Germany a few years ago as part of the new pricing policy of the scheme ec cash (so called "ec cash 2.0."). The retailer should be able to opt for additional services like PIN-authorisation or payment guarantee offered by the issuing banks or third parties besides the core service of a plain card payment (with a small scheme-wide fee).[14]

So if the BPA will be a new requirement for card schemes (e.g. as new SCF-requirement), issuers have to offer a BPA-card (like the debit card today) and acquirers have to offer a BPA-fee for the acquiring of a guaranteed payment card transaction, separated from other acquirer services. This is business-as-usual and not very exiting. The only consequence would be a cost-based MIF and therefore a single merchant fee for all kinds of cards (debit cards, credit cards, business cards, prepaid cards etc.) within all SEPA card schemes.

[14] Unlike the stakeholders quoted above, German banks did not see a payment guarantee as „basic service" but rather as a value-added that was supposed to carry an extra charge.

But if the BPA is an application, which could be offered without one of the card brands of the traditional card schemes (as suggested by EuroCommerce), somebody (EPC, ECB?) has to provide the additional BPA-scheme. If at the same time, the BPA should be a basic functionality of every issued branded card (e.g. Visa) and the merchant will opt for basic function (including payment guarantee), should this transaction be a BPA-scheme transaction or a Visa-transaction?

The EuroCommerce proposal involves a mandatory requirement for all issuers and acquirers (banks and other PSPs) and not for card schemes. Issuers and acquirers could offer additional services. Therefore in this new world they do not need a brand or a traditional scheme (besides the BPA-scheme) anymore. So what is the remaining role of the existing SEPA card schemes which exist today (either as regional or SEPA-wide scheme)?

The BPA-idea, presented by the stakeholders, is still immature. Their proposals are strongly influenced by their sectoral interests. So let us wait and see what the ECB will say as originator of the basic card services idea. Whatever it is, it may have far-reaching consequences for the European card industry.

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