Topics of this issue:

1. European Parliament passes payment resolution

On November 20, 2012 the European Parliament (EP) has passed a resolution regarding "card, Internet and mobile payments".[1] In this document, the EP raises a large number of issues and proposes far-reaching regulations. The resolution is non-binding but it can be read as a demand vis-á-vis the European Commission to become more active in this field. Thus, it may have substantial consequences for the payment industry.

Our Comment

Given the large number of issues it seems best to comment on them one-by-one.

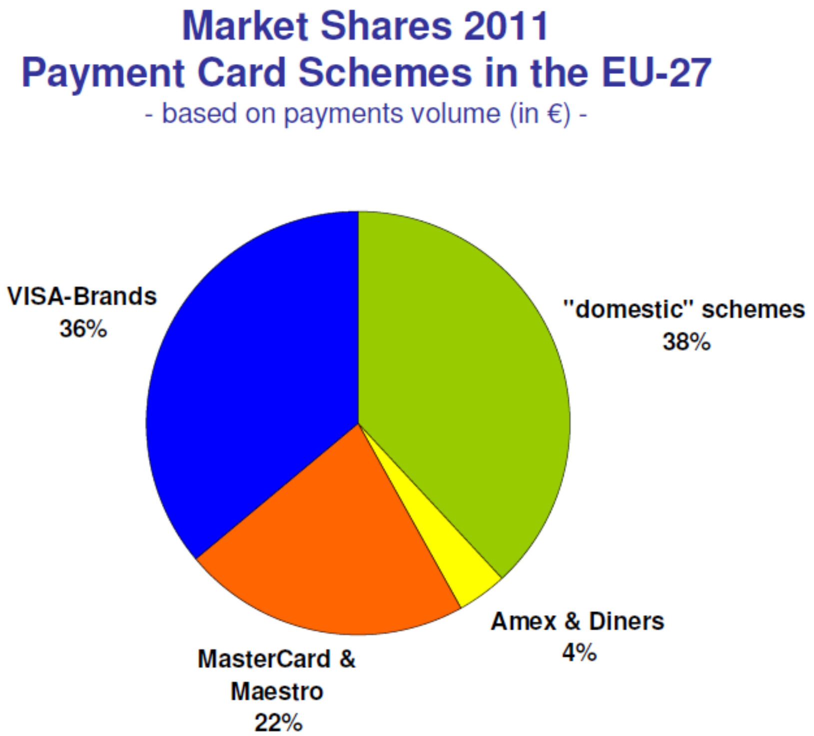
***The resolution:** "B. whereas the dominant position of two non-European card payment service providers can lead to excessive and unjustified fees …"*

***Our Comment:** This point comes up time and again. In the past we have been somewhat sceptical with respect to arguments brought up against MasterCard and Visa. But maybe there are sound reasons to insist on European governance for important payment schemes.[2] However, the governance structures of MasterCard and Visa are very different – at least with respect to Europe. Visa has created an almost independent entity, Visa Europe, that is run by European banks. So, one could well argue that Visa Europe is, indeed, a European scheme. If the legislators do not think so, they should specify what is lacking to make Visa Europe genuinely European.*

By the way: Are both schemes, Visa and MasterCard, really dominant? In the Euro-zone (SEPA) their common market share in card payments is about 35-40%. Former domestic schemes, (e.g. ec cash, Cartes Bancaires, Pagobancomat, Multibanco, Servired, Bancontact etc.) which are now all SEPA-compliant, are still dominating. But even in the EU-27 (with the leading UK-card market included) Visa and MasterCard´s market share is below 60%. Considering the "domestic" schemes as a group, the European card market is a more tri-polar world and not a duopoly of 2 schemes (see chart).

[1] European Parliament: Card, Internet and mobile payments. European Parliament resolution of 20 November 2012 on 'Towards an integrated European market for card, internet and mobile payments' (2012/2040(INI)).(http://www.europarl.europa.eu/sides/getDoc.do?type=TA&language=EN&reference=P7-TA-2012-426)

[2] See „A question of governance" in our Sept./Oct. 2011 newsletter.



Notes: Data are including POS-payments (no cash/ATM) of all cards (debit, delayed debit and credit cards) issued in the 27 EU countries. Payments of private label cards (like store cards and fuel cards) and e-purses (e-money) are not included. Domestic schemes, which are phased out during 2011 (e.g. „PIN" in the Netherlands), are not subsumed under „domestic schemes", but already classed as their expected new brand affiliation.
Sources: ECB Data Warehouse, annual reports of schemes, Nilson Report and others

The resolution: *"F. whereas the Green Paper does not tackle the costs and societal impacts of cash or cheque payments in comparison with card, internet and mobile payments, thus preventing a comparative analysis of the economic and welfare costs and societal impacts of payments by cash or cheque"*

Our Comment: *So far, comparisons of different payment instruments have focussed almost exclusively on costs. The idea behind this seems to be that payments are regarded as a commodity service. One payment instrument is considered to be as good as any other and there are no differences beyond speed and security taken into account. However, in reality, various payment instruments may offer very different features: guarantee, speed, irrevocability, refund terms transport of additional data, level of privacy, currency and regional coverage etc.. Obviously, depending on the mix and the actual design of these features,* *costs are also likely to differ. Depending on circumstances, some of these features are more valued by the payer, the payee or both and both parties may be willing to pay extra for some of these features whereas they are not willing to pay for others. In other words, the benefit of a payment instrument depends on various features and the intended use case of payers and payees. Therefore, lowest costs cannot be the only criterion for assessment of payment instruments. Thus, the EP should be welcomed to demand a broader scope when assessing payment instruments.*

The resolution: *"G. whereas the current business model for card payments allows excessive levels of multilateral interchange fees (MIFs) which seem sometimes to exceed the actual cost of financing the system, and which constitute a major barrier for to competition in the payments market;…"*

"41. Notes that after a transitional period, a person coming from any Member State should have his or her SEPA-compatible payment card accepted at every payment terminal in the SEPA, and that the payment should be safely routed; notes that this requirement might imply that MIFs need to be regulated to fall under a threshold, and insists that this should not result in an increase of MIFs in any Member State but rather to a decrease and, perhaps, a reduction towards zero at some later stage."

"43. Considers that MIFs should be regulated at the European level, with the aim of ensuring easier access for new market players to cross-border acquiring, thereby providing merchants with a real choice of which payment schemes they wish to join; …; recalls that Article 5 of Regulation (EU) No 260/2012 establishing technical and business requirements for credit transfers and direct debits in euros provides that no per-transaction MIF can be applied after 1 February 2017; calls for the same approach for card payments;"[3]

Our Comment: *In the world of payments, multilateral interchange fees (MIFs) are one of the most controversial topics. Internationally, MIFs are increasingly restricted but not prohibited altogether. However, the European Commission has set a precedent with respect to direct debit MIFs. Thus, it does not come as a surprise that the EP wants the same approach applied for card payments. Since the resolution is non-binding, the EU Commission may decide not to follow the proposal of the EP. But at the moment, it seems quite likely that the Commission will act accordingly.*

One point should be noted: the expectation that a European regulation of MIF for card payments will promote cross-border acquiring indicates a fundamental misunderstanding of

[3]See also (39), (40) and (42) of the resolution.

the concept of domestic MIF and cross-border MIF. As the MIF-rate depends only on the residency of the card holder and the residency of the merchant, a cross-border acquirer pays exactly the same MIF as a domestic acquirer, even under the current MIF implementation of the card schemes,

We would also like to mention that under (41) there is an interesting idea regarding the benefits of a low and uniform MIF. It is pointed out that acceptance of a SEPA card could be reached by a low (possibly zero) SEPA-MIF. In such a case, costs would be (almost) equalised and merchants would have an incentive to accept all SEPA brands.

The resolution: *"44. Considers that the business model for three party and mixed payment schemes may raise competition concerns similar to those for four party payment schemes; believes, therefore, that all card schemes – whether four party, three party or mixed schemes and any new market entrants – should be treated equally …"*

Our Comment: *This argument sounds plausible. But it raises some fundamental questions. If MIF in 4-party schemes is restricted to zero – what does "equal treatment" imply for 3-party schemes? To be sure, on the basis of prices charged to merchants and card holders, one can argue that a kind of "implicit MIF" exists. However, how should such an implicit MIF be regulated? The only way would be to regulate merchant service charges. So, in case of 3-party schemes, the entire end-user price applicable on the acquiring side would have to be regulated. So, regulation would be going further than in the case of 4-party schemes. An alternative would be to force 3-party schemes to open up and adopt a 4-party architecture.*

In the end, if the EU Commission follows the resolution on this point, regulation may have a bigger impact on 3-party systems than on 4-party systems.

The resolution: *"9. Calls on the Commission to reform the SEPA governance to ensure that the decision-making process is democratic, transparent and serving the public interest; notes that this requires a more active and leading role of the Commission and the European Central Bank (ECB) in the SEPA governance, as well as balanced representation of all relevant stakeholders in all SEPA decision-making and implementing bodies, guaranteeing sufficient involvement of end users"*

"32. …; considers it to be in the public interest to define objective rules describing the circumstances and procedures under which card payment schemes may unilaterally refuse acceptance;"

"60. Believes that consumer refund rights should be strengthened, both in the case of unauthorised payments and in the case of undelivered (or non delivered as promised) goods or services, …;"

Our Comment: *The payment system is increasingly seen as a public infrastructure. Accordingly, regulators want more public control. Political institutions such as the Commission or the ECB should be involved as well as all stake-holders. Rules for refusal of acceptance are considered (which may imply a certain obligation to contract). Open standards should be used. And so on.*

Whether or not this approach will lead to desirable outcomes is open to debate. However, what is puzzling, is that the public utility view runs parallel with the view that payment services should be provided by competing companies. This parallelism does not produce a consistent political approach. On the one hand, regulators urge the industry to co-operate and on the other hand they are sending in the sheriffs when the industry does just that. On the one hand, regulators want all stake-holders involved and democratic decision making and on the other they want innovation. That does not work.

The resolution: *"H. whereas cross-border acquiring is an option currently open only to a limited number of players, …;"*

"36. ... expresses concern at existing national, legal and technical barriers, such as some licensing terms, which should be removed in order for a non-domestic SEPA-compatible acquirer not to be treated differently to a domestic acquirer in that country; …"

Our Comment: *Somehow, the EP seems to imply that there are still formal restrictions such as licensing restrictions that make cross-border acquiring impossible for all but a "limited number" of players. Such restrictions would violate SEPA rules. In the summary to the Feedback statements on the EU Commissions Green Paper*[4] *the Commission reports that "A significant number of banks and payment schemes were of the view that obstacles to cross-border/central acquiring do not or no longer exist". This is also in line with the self assessment of card schemes.*[5]*Thus, formal licensing restrictions no longer are a problem. What remains are practical problems such as "local bilateral rules, different standards and*

[4] European Commission: Feedback statementon European Commission Green Paper "Towards an integrated European marketfor card, internet and mobile payments", p. 6.

[5]According to the ECB, the following schemes have published self-assessments: Activa (SI), American Express, Bancomat / PagoBancomat (IT), CartesBancaires (FR), Euro 6000 (ES), Girocard (DE), LaserCard (IE), MasterCard, Multibanco (PT), PIN (NL), Servired (ES), Sistema 4B (ES) and Visa.http://www.ecb.eu/paym/sepa/elements/compliance/html/index.en.html

different national settlement and clearing protocols, processing requirements and technical terminal-related differences" (p. 6) and – one might add – language.

The resolution: *"5. Underlines the need to advance towards a real-time clearing and settlement system, which technically is already within reach and used for some payments, and stresses that moving to a real-time economy should be an important goal for the whole SEPA and that an advanced real-time interbank system would need to have SEPA-wide reachability; …"*

"20. Notes that basically all payment transactions contain the same kind of data, and stresses that there should be safe data communication for any payment allowing straight-through, end-to-end real-time processing; sees the advantages of all systems using the same message format, and recalls that the most obvious choice is the one used for credit transfer and direct debit as defined in the Annex of the SEPA End-date Regulation (i.e. ISO XML 20022); recommends that the same message format should be used in all transaction data communication from terminal to customer and carry all relevant information;"

Our Comment: *Maybe we have misunderstood something but as far as we know, clearing and settlement of basic retail payment products (direct debits and credit transfers) is still a batch process. Moreover, the new SEPA products also have been defined for batch processes. So how can real-time clearing be "within reach"? And what are the implications for e-/m-payments. Should providers wait until retail payments have gone real-time?*

The resolution: *"7. Notes that all terminals should be able to accept all cards and fulfill interoperability requirements and, therefore, that any technical barriers resulting from differences in the functionality and certification requirements for terminals should be removed, as common standards and rules, and standardised terminal software, would increase competition;"*

Our Comment: *Maybe we are reading a bit too much into this, but should there really be no functional differences? That would imply that each prospective innovation would have to be agreed by all banks and PSPs jointly (together with regulators and stakeholders) and then jointly rolled out. That seems to be a blueprint for no innovation at all.*

The resolution: *"I. whereas surcharges for the use of card payments are not allowed in some Member States but are widely in use in some others, and whereas excessive surcharges have been to the detriment of consumers as <u>payment providers</u> often do not provide alternative payment methods to payments with surcharges;"*

Our Comment: *Maybe this is just a slip of the pen. But maybe it is also an example of a view of the payment world that likes to see merchants as "victims" (for instance of high* *interchange') and banks and PSPs as villains. Therefore, we would like to point out that surcharging is an activity carried out by merchants – not by PSPs.*

The resolution: *"11. Points out that while electronic payments are playing an increasingly important role in Europe and in the world, serious obstacles remain for a fully and effectively integrated, competitive, innovative, safe, transparent and consumer-friendly European digital single market with regard to these forms of payments;"*

13. Notes that the development of transparent, safe and effective payment systems in the European digital market is essential in order to ensure a genuine digital economy and facilitate crossborder e-commerce;"

"15. Stresses that, in this connection, measures should be taken to put an end to the frequent discrimination of European consumers whose payments for crossborder online transactions are not accepted because of their provenance …"[6]

Our Comment: *This is an evergreen. But we fail to see its relevance. Where is the army of shops that cannot sell to foreigners because of a lack of suitable payment instruments? Where are the crowds of customers that were not accepted due to their "provenance"? In short, where is the evidence?*

The resolution: *"10. Expresses concern at any unduly tight regulation of internet and mobile payment markets at this stage because such payment methods are still in the process of development; considers that any regulatory initiative in this field runs the risk of giving undue emphasis to already existing payment instruments, and may thus deter innovation and distort the market before it has been developed; asks the Commission to adopt an appropriate approach to any future internet and mobile payment methods in a future proposal, ensuring a high level consumer protection, especially for vulnerable consumers;"*

Our Comment: *The EP definitely makes a valid point. If innovation is an important goal, the risks of too much regulation are indeed huge. In this respect, one should also ask whether a start-up should be required right from the start to become a "pan-European SEPA-compliant scheme" – as seems to be implied by paragraph (6).*

Moreover, the idea that too much regulation may stifle innovation also applies to more mature markets – like the card market. Interbank associations that run on the principle of mutual agreement have often found it difficult to innovate. Thus forcing everything into the EPC and making the EPC more "democratic" may imply low levels of innovation.

[6] See also paragraph (12) and (14).

The resolution: *"48. … stresses, therefore, that merchants should accept one commonly used payment instrument without any surcharge (SEPA-compliant debit card, e-payment), and that any surcharges on other instruments may not at any point exceed the additional direct costs of those instruments compared to the instrument accepted without surcharge …""51. urges, therefore, the Commission to conduct an impact assessment on banning the possibilities for excessive surcharges in relation to the merchant fee as well as on a Europe-wide ban on surcharging, in light of Article 19 of the Consumer Rights Directive 2011/83/EU;"*

Our Comment: *Surcharging is seen critically and there seem to be members of parliament that would like to see surcharging banned (see 51.. above). However, the EP also comes up with a proposal that seems more practical than the approach taken by the Commission in the Consumer Rights Directive 2011/83/EU. While the Commission proposes a cost-based surcharge, the EP wants one commonly used means of payment to be free of surcharges and wants to set the maximum surcharge for others to the differences in direct costs (vis-á-vis the zero surcharge instrument).*

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