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1. New regulatory initiatives from the European Commission

At the 14th PaySys Breakfast Meeting (May 3rd, 2013), Jean Allix from the EU Commission (DG Competition) gave a presentation "New regulatory initiatives from the EU Commission". The meeting was attended by 50 representatives of the German payment card sector who were curious to learn more about the plans of the EU Commission. The first important point of the presentation was that proposals to modify the Payment Services Directive and regulate MIFs would be published in June.

Subsequently, Allix discussed those elements that are of particular relevance for card payments, in particular the treatment of MIF (multilateral interchange fees) and business rules of card payment schemes.

As Allix pointed out, in the past, competition enforcement had not always been very effective because anti-trust proceedings (including legal battles in court) could take many years. As an example, he mentioned the MasterCard case that was opened in 2001 and was expected to end in 2014 with the decision of the European Court of Justice. Therefore, the EU Commission contemplated other measures to restrict MIFs.

Before turning to such measures, Allix addressed the question "What is the problem with MIF?" He particularly stressed the following points

- A jointly agreed interchange fee establishes a floor for MSCs.
- Cards are widely used so that merchants basically have to accept cards.

Both these factors together imply that the issuing side has the power to dictate prices and that there is a kind of "reverse competition" taking place: the more expensive card scheme gains and the cheaper one loses. As an example, he cited the UK where Visa debit had won almost the entire market due to higher interchange than rival Maestro.

Apart from MIF, there are other features of payment card schemes that the EU Commission views as problematic: HACRs (hour all cards rules) and NDRs (non discrimination rules).

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Moreover, the Commission is not happy with the practise of acquirers to provide blended rates for merchants.

Jean Allix underlined that the EU Commission was not willing to accept the current state of affaires. But he also pointed out that exact nature of the coming proposal had not yet been decided.

He mentioned a ban or a cap as possible measures on MIF, pointing out that the EU Parliament wants a MIF rule for cards similar to the rule for SDD (zero MIF from February 2017 onwards).

Other potential measures are

- a ban of HACRs and blending so that there would be more price competition between brands,
- regulating interchange rules for x-border acquiring ("Why not MIF of the country of the acquirer?"),
- ban of NDRs, so that merchants could discriminate against relatively expensive payment instruments.

Allix noted, however, that the EU Parliament is opposed to surcharging. The Commission seems to see surcharging in a more favourable light but would prefer merchants to offer rebates for low-cost payment instruments rather than surcharge relative expensive payment instruments.

One of the questions from the audience also touched the issue of x-border transactions. A representative of one of the large German acquirers asked about the practice of some e-tailers to locate headquarters in small countries and provide these services "x-border" in order to profit from the low x-border interchange fee. As he pointed out, not all acquirers were prepared to go along with such a practise because it violated scheme rules. But Allix did not see a problem in this practise. For him, this is just competition.

Jean Allix also stressed the particular importance of co-badging rules – most importantly the rules regarding choice of application. He highlighted that such rules would be even more important for wallets that may host many payment applications. According to Allix, the EU Commission opposes blanket solutions. Merchants and consumers must be able to make a decision on a case-by-case basis.

Our comment:

It did not come as a surprise that MIF was the most controversial issue at the presentation. The audience raised many points in defence of MIF: the potential harm for consumers, the *implications of the recent Spanish experience with MIF regulation, the appropriate fees for issuing services, the fact that competition may actually be working (e.g. ELV in Germany), the higher implicit interchange fees of 3-party schemes, etc. Allix discussed them all but found them all wanting. Well, this could have been expected. The issue is not new and the EU Commission has made up its mind, long ago, to intervene in the market and impose some kind of restriction. However, it is interesting that the EU Commission is still pondering the particular form of this restriction, or set of restrictions. The easy way would be to follow the demand of the EU parliament and treat cards like direct debits. However, the Commission does not seem to be entirely happy with this proposal. For the moment, it looks like we will have a mix of MIF regulation and regulations of business rules (NDR, HACR, x-border acquiring, application selection). But since the proposal will be published in a few weeks' time, it does not make any sense to speculate. Let's wait and see what comes up in June!*

2. Rumours about Visa Europe

Recently, there have been rumors in the market about a potential sale of Visa Europe to Visa Inc.[1] According to these rumors, many member banks were tempted by the prospective revenues they could expect from such a sale. However, it was also said that some banks might wish to keep the processing capacities of Visa Europe. In the end, the meeting of the Visa Europe Board passed and nothing happened.

Our Comment

When Visa Inc. went public in 2006, the European part of the business was not included. It remained a membership organisation of European banks operating as a licensee of Visa Inc.[2] Moreover, Visa Inc. and Visa Europe entered a Put-Call Option Agreement: This agreement provided Visa Inc. with a call option that allows it to purchase Visa Europe under certain conditions (a drastic decline of the Visa merchant or ATM network in Europe). At the same time European member banks received a put option that allows them to sell Visa Europa any time they wish.[3]

In our view, it seemed to be a smart move to preserve the association structure because this would allow Visa Europe to promote V PAY as a "European" product. However, so far,

[1] See, for instance, "Banks in talks to sell Visa Europe", Card International, April 2013.
[2] See "Visa goes public" in the November 2006 edition of this newsletter.
[3] Excerpt from 10-K SEC Filing, filed by Visa Inc. on 21.12.2007.

European regulators are reluctant to regard V PAY as a truly European scheme. As a consequence, it does not seem to be implausible that some of the member banks of Visa Europe should contemplate selling the venture. Thus, in the end, the fate of Visa Europe might be the same as the fate of Europay which was sold to MasterCard in 2002. However, for the moment, it is clear that rumours were just rumours and no concrete steps were taken at the last board meeting. But one thing seems to be sure: Such rumours will return.

3. China's UnionPay: WTO demands a change of rules

In 2011 Visa complained against the treatment of foreign PSPs in China and the U.S. took the case before the WTO (World Trade Organisation).[4] The WTO opened formal proceedings and concluded in 2012 that China had violated some of its commitments under the GATS (General Agreement on Trade in Services) schedule.[5]

The WTO panel first examined what commitments China had made under the GATS Schedule and concluded that electronic payment services (EPS) are covered.

It then determined that

- China had <u>not</u> committed itself to allow the cross-border supply of EPS into China by foreign EPS suppliers
- China had committed itself to allow foreign EPS suppliers to supply their services through commercial presence in China
- China had committed itself to a national treatment of foreign EPS suppliers.

Based on these findings the WTO panel looked at the current regulatory treatment of foreign EPS and found that China had acted inconsistently with a number of its commitments. In particular, the panel found that China maintains CUP as a monopoly for RMB cards

- issued in (mainland) China and used in Macao and Hong Kong
- issued in Hong Kong and Macao and used in China

But for cards issued in China and used in China the panel found no inconsistencies because China committed to national treatment but not to cross-border provision of services.

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[4] See "Co-badging woes: Visa versus CUP and BC Card" in the August 2011 edition of this newsletter.
[5] For a short summary, see: DISPUTE SETTLEMENT: DISPUTE DS413. China - Certain Measures Affecting Electronic Payment Services.
http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds413_e.htm

Finally, the panel ruled that the issuer requirements are inconsistent with national treatment commitment for ESPs from other WTO-Members. The same applies to the terminal equipment requirements and the acquirer requirements.

China decided not to appeal and has to implement the panel's recommendations until 31 July 2013.

Our comment:

For a number of years already, a European Card Scheme has been high on the wish-list of European policy makers. However, nothing much has been happening. Meanwhile, in another part of the world, a new scheme with global ambitions has been emerging: UnionPay (formerly China UnionPay). UnionPay is a public enterprise that has been protected against foreign competition, so far. The WTO ruling will change this, but it remains to be seen how effectively foreign competitors will be able to compete in China, in the future.

It seems certain, however, that the WTO ruling will not stop the rise of UnionPay which keeps expanding abroad. Its strategy seems ambitious but UnionPay is definitely becoming a heavyweight in the world of cards. In 2012, the purchase volume of UnionPay amounted to $3.3 trillion, compared to $5.7 trillion made with Visa- branded cards and $2.7 trillion made with MasterCard-branded cards.[6]

Internationally, the Chinese scheme has been particularly active on the acquiring side of the market. It claims to be accepted in 141 countries (POS and ATM).[7] *Its cloud on the acquiring side and the size of the ex-pat population allow UnionPay to also consider an international expansion on the issuing side. Thus it has launched its first card issued in the US.*[8]

Even though, European decision makers might be a bit envious of UnionPay's success, the "UnionPay story" is hardly a blueprint for Europe.

- *Europe already has advanced card payment systems and does not start from scratch.*
- *Visa and MasterCard are already part of the European card payment landscape.*
- *Europe is committed to free trade in goods and services (hopefully).*

[6] Chinas UnionPay Payment Network Launches Its First Card Issued in the U.S. By Dow Jones Business News, April 29, 2013 (http://www.nasdaq.com/article/chinas-unionpay-payment-network-launches-its-first-card-issued-in-the-us-20130429-01397)
[7] See www.en.unionpay.com
[8] See "Chinas UnionPay Payment Network Launches Its First Card Issued in the U.S.", quoted above.

- *The European Commission cannot simply decide to create its own card payment scheme.*[9]

Thus, Europe could not and should not try to follow the Chinese example. Creating new state enterprises is not something that would strengthen competition in the payment market.

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[9] Arguably, the ECB could do this. After all, it is already running TARGET2 and TARGET2-Securities. However, central banks usually remain on the wholesale side of the payment market – probably a wise decision.